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RUEHHK/AMCONSUL HONG KONG PRIORITY 0208
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C O N F I D E N T I A L SECTION 01 OF 03 BANDAR SERI BEGAWAN 000229

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DEPARTMENT FOR EAP/MTS AND EB/OMA

E.O. 12958: DECL: 07/31/2017

TAGS: [EFIN](#) [ECON](#) [PGOV](#) [BX](#)

SUBJECT: BRUNEI TO REVIEW SOVEREIGN WEALTH FUND MANAGEMENT
POLICY

Classified By: DCM Justin Friedman, reasons 1.4 (b) & (d)

SUMMARY

11. (C) The visit of U.S. Treasury experts to initiate a dialogue on sovereign wealth fund management practices succeeded in raising the issue at senior levels of the GoB. Brunei sees itself as a small player in global wealth management. The Brunei Investment Agency declined to disclose details to us of how much and how it manages the GoB's foreign investments, but asserted that it adhered to industry standard practices. High oil prices have made the GoB flush with cash and Brunei's foreign holdings are likely to continue to increase. A dialogue based on IMF backed best practices is the most likely way to bring more transparency to GoB's sovereign wealth fund management. END SUMMARY.

Smaller but Experienced Sovereign Wealth Fund

12. (C) U.S. Treasury's Robert Kaproth, Director of the Office for International Monetary Policy, and Benjamin Cushman, International Economist in the Office of Asian Nations, visited Brunei July 19 to initiate a dialogue with the GoB on sovereign wealth fund (SWF) management. Together with the DCM, they briefed senior officials at the Ministry of Finance, the Currency Board, the Brunei Investment Agency (BIA), and prominent local banking and accounting officials on the U.S. interest in working with our partners to develop a better understanding of the role of SWFs in the global economy. Dato Hj Ali Apong, Permanent Secretary at the Ministry of Finance and member of the Board of BIA, told the visiting Treasury team that this visit had raised issues he had not previously considered and that he would welcome further dialogue and input from the IMF and World Bank on SWF best practices. However, Ali noted, and in a separate meeting, BIA acting Managing Director Pg Abdul Rahman Salleh echoed, that BIA was too small to influence markets,

particularly when compared to larger and more experienced SWFs.

13. (SBU) By law, the Brunei Investment Agency's (BIA) primary function is to hold and manage the GoB's external reserves. All funds it manages come from the Ministry of Finance (MinFin). Financial industry observers estimate the value of BIA's holdings at approximately USD 30 billion, in the top ten globally among sovereign wealth funds. The GoB -- and more particularly, the royal family when now-exiled Prince Jefri was Finance Minister and ran the family's and the GoB's intermixed investments -- earned a reputation in the roaring 1990s for spendthrift excess and lax management of its sovereign wealth funds. This mismanagement came to a halt when Jefri ran afoul of his brother, Sultan Hassanal Bolkiah, and the law with his mis-managed Amadeo Investment Company which went bankrupt around the time that the Asian financial crisis combined with low world oil prices left the GoB relatively short of cash. One industry estimate is that Brunei's overseas investments peaked at USD 100 billion in the late 1990s.

Internal Accountability over External Transparency

14. (C) Dato Ali said that the "Prince Jefri" problem was caused, in part, by the BIA board not exercising sufficient oversight and attention to the SWF performance. As a result, stronger internal audit and scrutiny by "other public organs" were now standard practice. Both Ali and Rahman said that accountability to the BIA Board of Directors, and by inference, to the Sultan, were sufficient to ensure no repeat

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of the Amadeo problem. The GoB has also looked to Singapore, Abu Dhabi, and Kuwait for models of how to run its SWF. BIA regularly conducts internal audits to ensure internal guidelines are adhered to and the guidelines themselves are regularly reviewed. BIA employs a total of 204 staff from fund managers to chauffeurs. Fund managers' performance is tracked to industry benchmarks. By law, employee compensation cannot be based on the performance of the assets managed.

15. (C) Neither Ali nor BIA's Abdul Rahman saw a need to make the GoB's and BIA's investment strategies and portfolios more transparent to the public beyond existing disclosure rules in the markets in which they invest. Abdul Rahman stated that BIA operates in many ways like a "fund of funds," making direct investments in companies and investing in managed funds. The GoB structures its internally managed investments with a focus on long term returns and follows the results of leading fund managers to measure how its portfolio is performing. Brunei's government secrecy laws forbid disclosure of BIA's portfolio, so BIA officials could only assure us that asset allocations were similar to peer averages. Ali said that through BIA, the GoB has a sizeable fixed income portfolio with relatively low returns. Other assets include real estate, hedge funds, venture capital, and some commodities. BIA officials declined to state the total size of the assets under BIA management, but did not object to the USD 30 billion estimate. Similarly, they did not disclose their achieved rates of return, but did indicate that they maintained a real return target for the aggregate portfolio. Abdul Rahman said that internal guidelines restrict the size of its investment in any one company -- including shares held through intermediary investment funds -- to five percent. BIA officials also said that they do not exercise voting rights on portfolio equity shares held in internally managed funds.

Not All Eggs in BIA Basket

¶6. (C) Possibly as a lesson learned from the Amadeo collapse, the MinFin has placed some assets directly with other managers. Pakistani national Saquib Mawar-Khan (protect), Brunei director for Emerging Markets Partnership (EMP), told us that the Ministry of Finance was a major investor in the Washington, DC-based EMP's Islamic Development Fund. (Note: asset allocation is available on EMP's internet site <http://www.empglobal.com>) The MinFin is a "substantial investor," holding a "major share" of the USD 730 million in the 10 year, closed end fund. Mawar-Khan said that the GoB's investment was a critical factor in EMP opening an office in Brunei and the MinFin has a seat on the fund's managing board. Although MinFin often delegates its board seat to a BIA official, the Minister of Finance II, Pehin Abdul Rahman Hj Ibrahim, often comes himself to board meetings and is an able and active participant. The IDF has been a success for EMP, far exceeding its target internal rate of return of 18 percent and work has already begun to create a second fund targeted at investments in Islamic countries with a planned total capital of USD 1 billion. (BIONOTE: Mawar-Khan is an experienced investment banker, having worked in New York and London for major investment brokerages. He was Pakistan's Ambassador to Brunei in 1989-1990 and returned to Brunei five years ago to open the EMP office here.)

¶7. (C) The MinFin is also in the process of creating a new domestic investment fund to help diversify Brunei's economy away from the oil and gas industries which it will capitalize at USD 300 million. An AMCIT director of the U.S.-owned financial firm which will probably be engaged to manage this fund told the Ambassador that it would provide venture capital to projects in Brunei in partnership with foreign direct investment. The two "rules of the road" for this new

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fund is that the projects must create jobs and do at least fifty percent of their work in Brunei and may not invest in oil and gas projects.

COMMENT

¶8. (C) Continuing high oil prices have helped boost Brunei's GDP growth to its highest level in a decade, 5.1 percent for 2006, and softened memories of the leaner times of the last decade. The GoB has a hard time spending all the funds it currently allocates to the state budget, so the short to medium term prospects are for ever larger contributions to BIA. The continuing challenge for the GoB will be to avoid slipping into complacency and reducing vigilance in overseeing how its SWF is managed. Greater transparency in public finance has been a slow but steady trend here since the Sultan reopened the Legislative Council in 2004 and introduced some public debate on the state budget. Nonetheless, the line between GoB and royal family finances remains fuzzy. While we don't expect a major change in current practices at BIA, a dialogue with the GoB focused on increasing transparency in public finance in line with IMF and World Bank approved best practices is our best approach to bringing more of the GoB's financial practices into the open. END COMMENT.

¶9. (U) Treasury cleared on this message.
SKODON